



CITY OF HAYWARD

AGENDA REPORT

AGENDA DATE 10/26/99

AGENDA ITEM 3

WORK SESSION ITEM _____

TO: Mayor and City Council

FROM: Finance and Internal Services Director

SUBJECT: Annual Investment Report, Revisions to Statement of Investment Policy and Delegation of Investment Authority

RECOMMENDATION:

It is recommended that the City Council 1) receive the Annual Report on Investment Program and Activity for the Fiscal Year Ending June 30, 1999, 2) affirm the Statement of Investment policy, and 3) renew the delegation of authority to make investments to the Director of Finance or his or her designee.

BACKGROUND:

The City's Statement of Investment Policy requires that staff submit to the City Council an annual report on the City's investment program and investment activity; further, any changes recommended in the City's Statement of Investment Policy are submitted to the City Council at this time. In addition, the state statutes that govern investment activity require the City Council to annually reaffirm the Statement of Investment Policy, regardless of whether any changes are recommended, and to annually confirm the delegation of investment authority.

Attached for Council's review is the Annual Report on Investment Program and Activity for the year ended June 30, 1999. Upon recommendation of the Investment Advisory Committee, no changes to the Statement of Investment Policy are recommended.

The Annual Report on Investments

The following is a brief review of the report noting some of the key statistics and achievements for the year.

The year 1998-99 was notable for the health and strength of the domestic economy. This year continued the pattern of growth and subdued inflation that has characterized the preceding two years, although both the rate of growth and the level of price increases were greater than was the case last year. By the spring the stock market had rebounded from a late summer early fall trough,

with the Dow Jones Industrial Average increasing 23.4% during the fiscal year. This is in addition to increases of 12.5 % and 40% in two previous years. The continued buoyant performance of the stock market was attributable to a number of factors, not the least of which was increased corporate profitability as well as the continued growth of the economy and relatively benign inflationary climate. Inflation continues to be remarkably subdued, particularly in view of the fact that the current business expansion is several years old.

The following comparative statistics display the result of the events of the year on the City's portfolio in comparison to previous years:

Thousands (000)	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>
Average portfolio value	\$62,008	\$65,998	\$71,132	\$76,876
Annual portfolio earnings	3,548	3,742	4,119	4,244
Annual portfolio yield	5.77%	5.67%	5.79%	5.52%

Available cash for investment rose in 1998-99, by \$5,744,000 or 8.1%. This compares to increases of 7.8% last year and 6.4% in 1996-97. Overall, this is indicative of balanced operating budgets and use of bond proceeds rather than current revenue to finance improvements, as well as the continued effect of a healthy local economy. Portfolio yield decreased to 5.52% and portfolio earnings increased approximately \$125,000 or 3.03% over the prior year. The increase in earnings is attributable to the larger average portfolio value and consequent increase in funds available for investment, since yield did decline from the level of the prior year.

When expressed as a percentage of the performance target (the average of the rates of thirteen and twenty six-week Treasury Bills plus 50 basis points), portfolio performance averaged 109.94% of the target for the year. This compares favorably to last year's 103.79%. The performance rate at the beginning of the year was 104.9%. It peaked at 126.93% during October when the target rate was at its low point for the year, and it fell to a low of 101.53% at year end as market interest rates began to rebound and portfolio yield stabilized near 5.3%.

During 1998-99 Investment Policy standards for quality continued to be exceeded. 47.5% of the dollars invested during the year were done so at the highest rating, AAA. Similarly, all negotiable certificates of deposit purchased, comprising 12.5% of invested dollars, were of the highest level of quality for this type of security, A1+/P1, together these represent 60% of all invested dollars outside of L.A.I.F., totaling \$24 million.

In other areas of performance, liquidity needs continue to be met as investments in L.A.I.F. are immediately accessible, and other investments mature during the year. The portfolio is diversified in accordance with Policy requirements and sound practice.

The investment strategy assumes that rates will stabilize at the levels prevailing following the most recent rate increases by the Fed in June and August of this year. There remains the possibility, however of further increases if the Fed does not believe that the increases (50 basis points) are sufficient to combat inflationary pressures. As a consequence, we will continue to liquidate investments in L.A.I.F. over time and purchase alternative permitted investments. Such alternative types of investments will be considered in order to take advantage of increments of yield they may offer. All such purchases will be made in consideration of the diversification and cash flow requirements of the portfolio, and, of course, quality requirements will be met. L.A.I.F. will continue to be used to maintain adequate liquidity.

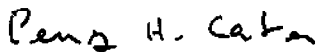
Revisions to Statement of Investment Policy

No changes or revisions to the Statement of Investment Policy are required or recommended at this time.

Status of Committee Expansion

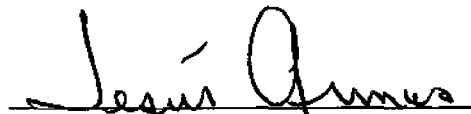
Previously, the Policy was amended to provide for the appointment of an additional member of the Advisory Committee from outside of the City's employment "family". This appointment would be made by the City Manager from a member of the financial community. . Ideally, such a member would reside or work in Hayward and possess knowledge and expertise concerning the economy, the activities of the Federal Reserve, and in private sector investment practices. As of this writing, recruitment efforts are continuing.

Prepared:



Perry H. Carter, Director of Finance

Approved by:



Jesús Armas, City Manager

Attachments: Exhibit A - Annual Report on Investment Program and Activity
Exhibit B - Statement of Investment Policy

Attachment A

ANNUAL REPORT
ON
INVESTMENT PROGRAM AND ACTIVITY

For the Fiscal Year Ending

June 30, 1999

Department of Finance

Date: August 30, 1999

I. INTRODUCTION

This report is prepared annually in compliance with the Investment Policy of the City of Hayward and the requirements of the State of California. The purpose of this report is to apprise the members of the City Council, as well as interested citizens, of the performance, composition, quality, diversity and liquidity of the investment portfolio of the City during the preceding fiscal year. Additionally, significant national political and economic events that have influenced the bond market during this period are discussed so that the performance of the portfolio may be viewed in context. This report also provides an opportunity for the City Council to conduct its review, and annually adopt the Statement of Investment Policy in accordance with state requirements, and to amend the policy as required to meet local needs or comply with legal requirements.

II. OVERVIEW OF 1998-99

The year 1998-99 was notable for the health and strength of the domestic economy, and for the action taken by the Federal Reserve in response to major difficulties faced by the economies of many foreign countries, particularly those in Asia. On the domestic economic front, this year continued the pattern of growth and subdued inflation that has characterized the preceding two years, although both the rate of growth and the level of price increases were greater than was the case last year. By the spring the stock market had rebounded from a late summer early fall trough, with the Dow Jones Industrial Average increasing 23.4% during the fiscal year. This is in addition to increases of 12.5 % and 40% in two previous years. The continued buoyant performance of the stock market was attributable to a number of factors, not the least of which was increased corporate profitability as well as the continued growth of the economy and relatively benign inflationary climate. Inflation continues to be remarkably subdued, particularly in view of the fact that the current business expansion is several years old. Specifically, the All Urban Consumer Price Index increased 2%, up only slightly from 1.7% last year; and Producer Prices for all commodities increased only 1.4%, although this compares to a decline of 1.9%, last year, as prices for energy and raw materials have rebounded somewhat from last year's low levels. The economy grew approximately 4% during the year, compared to 3.1% in 97-98, with the rate of growth strongest during the 2nd and 3rd quarters of the fiscal year. As was the case last year, vigorous consumer spending spurred economic growth.

International events during 1998-99 prevented the interest rate setting Federal Reserve Board (the Fed) from focusing only upon the domestic economy. Given the strength that prevailed in the U.S. economy during the year, the Fed most likely would not have acted to lower interest rates by 75 basis points as it did in the Fall, if it were not required to do so in response to economic difficulties overseas. The "meltdown" of the economies of several Asian economies created conditions that included

currency failures, withdrawal of credit, and a strong desire to invest in the safety provided by U.S. Treasury securities. These conditions increased the risk of global recession. Such an occurrence would have negative effects upon the health of the economy of the United States as well as that of foreign countries. As a consequence, the Fed made these interest rate reductions to stabilize and restore the confidence of the credit markets and demonstrate its willingness to take quick action to thwart the possible spread of recession from foreign economies to that of the U.S. With the strong economic growth that prevailed in the domestic economy, such a lowering of interest rates would likely not have occurred absent this threat of global economic chaos.

Movement of the monthly average of the rates of thirteen and twenty six week Treasury Bills which serves as the benchmark against which portfolio performance is measured clearly demonstrate the impact of the global economic crisis of last fall. As can be readily seen on Chart F and as tabulated on Chart C, interest rates plunged 98 basis points between the beginning of the year and October's low for the year. Interest rates rose somewhat and stabilized until April as conditions in the global economy begin to stabilize and improve. With this improvement, the Federal Reserve once again focused upon the strength of the domestic economy and, beginning in April interest rates began to rise in anticipation of a move by the Fed to raise rates. By June 30, interest rates were increased 25 basis points by the Fed's rate-setting Open Market Committee. As of year-end rates had risen to a level only 27 basis points below that which prevailed at the beginning of the year. The Target Rate, (equivalent to the monthly average discussed above plus 50 basis points) began the fiscal year at 5.51%, fell to its yearly low of 4.53% in October, rose and stabilized near the 4.90% level for most of the winter, and finally increased during the last quarter to finish the year at 5.24%. The Effective Yield of the portfolio was less volatile, mirroring primarily the lower level of rates which prevailed in 1998-99 compared to the previous year. It steadily declined from its high of 5.78% at the beginning of the year to 5.32% at year-end.

The following comparative statistics display the result of the events of the year on the City's portfolio in comparison to previous years:

	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>
	Thousands (000)			
Average portfolio value	\$62,008	\$65,998	\$71,132	\$76,876
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revenue to finance improvements, as well as the continued effect of a healthy local economy. Portfolio yield decreased to 5.52% and portfolio earnings increased approximately \$125,000 or 3.03% over the prior year. The increase in earnings is attributable to the larger average portfolio value and consequent increase in funds available for investment, since yield did decline from the level of the prior year.

When expressed as a percentage of the performance target (the average of the rates of thirteen and twenty six-week Treasury Bills plus 50 basis points), portfolio performance averaged 109.94% of the target for the year. This compares favorably to last year's 103.79%. The performance rate at the beginning of the year was 104.9%. It peaked at 126.93% during October when the target rate was at its low point for the year, and it fell to a low of 101.53% at year end as market interest rates began to rebound and portfolio yield stabilized near 5.3%.

III. ACHIEVEMENTS IN 1998-99

During 1998-99, accomplishments such as the following were achieved.

A. Exceeded Statement of Investment Policy standards for investment quality.

Moody's and Standard & Poor's and other rating agencies do not rate the Local Agency Investment Fund, the State investment pool in which the City has deposits. Yet, all investments in the City portfolio except for deposits in L.A.I.F. meet or exceed ratings required by State law and/or the City's Statement of Investment Policy. Chart E, attached to this report provides information relating to the rating of all securities purchased during 1998-99. This chart clearly shows that 47.5% of the dollars invested during the year were done so at the highest rating, AAA. Similarly, all negotiable certificates of deposit purchased, comprising 12.5% of invested dollars, were of the highest level of quality for this type of security, A1 + /P1. Together these represent 60% of all invested dollars outside of L.A.I.F., totaling \$24 million, and these investments are rated at the highest possible level of quality even though there is no legal or policy requirement that mandates purchases at such quality levels.

With the decline in interest rates during most of 1998-99, the premium offered for purchases of securities of lower quality, or "spread", increased from the levels which prevailed during the previous year. As a consequence, \$16 million, or 40% of invested dollars were for purchases of securities rated at less than the highest quality in order to take advantage of the additional increment of yield available from these securities. It should be noted, however, that all such purchases were of quality levels that exceed the minimum levels required by the Investment Policy.

Specifically, 15% of purchases, totaling \$6 million, were purchased at the double A level, which is the second highest quality category. Of these purchases, \$4 million were of the midlevel double A rating, that being AA2; and \$2 million was rated at the

lower double A rating, AA3. Although the Statement of Investment Policy allows for investments of up to two years at the lowest single A level, A3, no purchases were made at this level. Of the purchases rated single A, one half, totaling \$5 million, were at the highest level A1, and the remaining half were purchased at the midlevel of single A, A2. Altogether, 25% of purchases, totaling \$10 million were of securities rated single A.

The fact that this year's investments have exceeded the quality requirement by a substantial margin clearly demonstrates the commitment to safety required by the Investment Policy.

To facilitate review of the quality of the City's portfolio, the monthly Investment Portfolio Report includes a portfolio detail report that displays the rating of each security. These ratings are revisited monthly when portfolio prices are updated. Any rating changes are detailed in the report if they occur.

B. Enjoyed a trouble free audit of 1998-99 investment activity

Over the last nine years the City's data on investment activity has been organized to make auditing of Treasury more convenient for the auditors. This effort was successful again in 1998-99 for the audit of the prior year.

C. Converted all Spreadsheets to Excel format to ensure consistency with City standard. Updated monthly reports to include electronically linked graphics.

To provide ease of cross training and to ensure compatibility with City information processing standards, the spreadsheets that support the monthly and annual reports were converted to MS Excel from other spreadsheet formats. Additionally, the "Performance" and "Portfolio Composition" graphs included in the monthly reports are now electronically linked to these spreadsheets.

IV. PERFORMANCE INDICATORS

A. Safety and risk tolerance

As indicated above, the Statement of Investment Policy's quality standards were far exceeded in 1998-99. There were no exceptions to investment quality or other standards set by policy. This will be apparent from the following discussion of the various categories of City investment and of practices required in the administration of the investment program.

Negotiable certificates of deposit (unlike collateralized CDs, these trade on the open market and are rated on the credit worthiness of issuers, not on collateralization): Three Negotiable CD's with a par value of \$5,000,000 were purchased in 1998-99,

and the rating of these securities was at the highest possible rating for securities of this type and maturity, A1+/P1, although the Policy allows for purchase of this type of investment at the lesser A2/P2 level for a one-year maturity, or less. Additionally, one bank note, which is a CD equivalent product, was purchased. The par value of this security was \$2 million, and it was rated AA3, well in excess of the required A3 level. All CD and CD equivalent investments had maturities of one year or less.

Collateralized certificates of deposit have been de-emphasized because ratings of most savings and loan issuers do not meet policy standards. Collateralized CDs of well-rated institutions have not been competitive.

Banker's acceptances are securities based on sales of products, which serve as security for the transaction with underwriting of the transaction also being provided by the issuing bank. Because the Policy authorizes a maximum maturity of 270 days for Acceptances, these instruments were not competitive with rates available in the state investment pool, L.A.I.F. As a consequence, and as was the case last year, no Acceptances were purchased during 1998-99.

Commercial paper (corporate I.O.U.s of short duration): Though the City always has met the A1/P1 requirement, this security was not bought in 1998-99. Commercial paper was not competitive.

Medium term notes (MTNs), for City purposes, differ from negotiable certificates of deposit only by being issued by corporations or bank holding companies, not banks, and by having a bond method of interest calculation which is different than negotiable CD interest calculation. The policy standard for MTNs is the same as for negotiable CDs. Of the \$14 million of MTNs purchased, \$4 million were rated AA2; \$5 million were rated at the highest single A level, A+; and \$5 million were rated at the midlevel single A rating, A2. All purchases exceeded the minimum policy requirement of single A3 for the maturities purchased.

Repurchase agreements are collateralized securities, which are sold back to the seller on prearranged terms. No use was made of this category of security because "repos" were uncompetitive in 1998-99.

Asset backed securities (ABS) is a subcategory of medium term notes (MTN) which the State made a separate category to override the 30%-of-portfolio ceiling on MTNs. 20% in ABS can be bought under State law in addition to the 30% in MTNs, though City policy permits only 40% of the portfolio in the two security categories. ABS are the collateralized form of MTNs (see the definition in the Glossary of this report). Though State law permits investments in AA-rated asset backed notes; the City invests only in AAA-rated notes. One of these securities with a par value of \$2 million and a maturity of 2 years was purchased during 1998-99. This security is AAA rated.

Remaining investments, totaling \$17 million, or 42.5% of total invested dollars, were in federal agency securities, which are regarded as more secure than AAA, having in the case of the agency securities purchased, the implied guarantee of the United States.

In summary, staff continues to place a premium on investment safety. However, buying higher quality than necessary is not the only method used to reduce investment risk. Diversification, as discussed in section IIIB below, also reduces risk by spreading it over several types of investment and over many investment sources of excellent quality.

Practices required by the Policy: The Statement of Investment Policy's requirements were scrupulously observed with respect to the following:

1. Only qualified investment institutions were dealt with.
2. All transactions were executed on a delivery-versus-payment basis. This means that the City does not pay for securities until its title to them is confirmed.
3. Competitive bidding by at least three bidders was the standard method of security procurement, and all bidders were pre-qualified by agreement to comply with the City policies. Furthermore, no addition to the bidders' list is made without the concurrence of the Investment Advisory Committee.
4. Investment practices followed the written authorizations, controls and procedures initially developed in the mid 1980's, as revised by subsequent changes to the Statement of Investment Policy and approved by the City Council. Another safety consideration is investment safekeeping. All investment instruments are secured through third party custody and the safekeeping procedures of Sanwa Bank.

B. Diversification

Risk is diluted by diversifying types of investments, diversifying sources of investments, and correlating investment maturities with dates of cash needs.

The City uses a computerized cash management budget that plots expenditure requirements and income delivery for the entire year. Staff correlates investment maturities with cash need dates as a matter of routine. Charts A and B (attached) respectively detail diversification by investment type and investment maturity.

At year's end, the portfolio par values for the various types of investments were as follows: \$7,000,000 (8.2%) in negotiable CD's, \$4,000,000 (4.7%) in asset backed notes, \$20,000,000 (23.5%) in medium term notes, \$19,000,000 (22.3%) in Treasury and federal agency notes, \$34,800,000 (40.9%) in the state's Local Agency Investment Fund (L.A.I.F), and \$326,818 (0.4%) on deposit with the bank. The only

categories over which the portfolio was not diversified were those that were underperforming alternative permitted investments.

The portfolio has diversification of maturities and diversification of security types, in addition, L.A.I.F. spreads risk over more investment types and infinitely more investment sources than a City portfolio could utilize on its own. Moving money into L.A.I.F. improves diversification vastly. Hence, purchase of longer investments was done when improved earnings justified the longer maturities. Staff avoided pulling funds from L.A.I.F. in response to the illusion of diversifying. We moved money out of L.A.I.F. when yields rose to a level which justified the move to the longer maturities available outside L.A.I.F.

C. Liquidity

A portfolio has the appropriate level of liquidity if needed portions of it can be converted into cash to meet obligations and to take advantage of market conditions. Of these factors, the need to meet obligations is the most critical. To ensure adequate cash is available the City monitors its cash position daily, satisfying its obligations and investing the remaining cash. L.A.I.F. is the investment of choice for this purpose. L.A.I.F. offers the City overnight liquidity at rates which are usually equivalent to those of six-month investments. Additionally, L.A.I.F. is used as an investment alternative to other, longer term securities, typically during periods of rapidly falling rates, which was the case during 1998-99. This year, the proportion of the portfolio invested in L.A.I.F. was about 30% in July; but with the first quarter's rapid rate decline it had more than doubled, to slightly less than 63%, by the month of March. By year-end, it had declining to approximately 41% as market interest rates became more competitive, and alternative investments were made. This level of investment in L.A.I.F. at provided more than sufficient liquidity to more than cover foreseeable shortfalls in cash resulting from the normal variability of our many revenue sources. Additionally, there is nothing in the portfolio that cannot be sold immediately if the need arose, although it generally is our practice to hold investments until they mature.

The Statement of Investment Policy sets three major maturity constraints to insure liquidity:

1. The City shall not invest in instruments whose maturities exceed four years at the time of purchase. State law allows five-year maturities, but City policy is more demanding than State law in several important respects.
2. No more than 40% of the portfolio shall be invested beyond twelve months.
3. The average maturity of portfolio investments shall not exceed 400 calendar days.

During 1998-99 all policy constraints were met except that during the month of April more than 40% of the portfolio was invested beyond twelve months. The specific overage was 0.28%, representing a dollar equivalent of \$233,793. During April, six securities, with an aggregate par value of \$13 million were purchased. The final purchase during April was priced on the 27th of the month and, at the time of purchase there was no policy violation. With processing of payroll on the final day of the month, the payout of cash reduced the size of the portfolio sufficient to create the violation noted above. This policy exception was cured in May as \$4 million moved to the 270-359 day maturity category. To ensure such exceptions do not occur in the future, trial month-ending categorizations of maturities will be performed when purchases of securities of more than 360 days are contemplated, and a larger margin below the policy ceiling will be provided for when calculating such trial balances.

D. Yield

The Statement of Investment Policy says that portfolio is to be managed with an emphasis primarily upon safety, in consideration of liquidity needs, and then to consider yield. As can be seen in the previous sections, this policy direction has been followed, as demonstrated by the high quality, diversity, and liquidity of the portfolio. The need to maintain quality, diversity, and liquidity constrain the ability to maximize yield. Even so, portfolio performance exceeded the policy guideline during 1998-99.

Yield is the percentage of annual return on investment. As noted at the beginning of this report, average portfolio yield for the year decreased to 5.52% from the 5.79% recorded in 1997-98. As a result of the increase in the total value of the portfolio, however, annual portfolio earnings totaled approximately \$4,243,500, representing an increase of \$125,000 from 1997-98, despite the decline in yield.

Unlike 1997-98, which was characterized by steady economic growth, lack of economically disruptive news, and stable interest rates with little variation from high to low, economic markets in 1998-99 were characterized by strong domestic growth coupled with tumultuous global events, most notably severe crises in the economies of several Asian countries. The uncertainty in financial markets created by these events was manifested by a 98 basis point decline in the benchmark rate from July to October, followed the next month by a 40 basis point rise. Relative calm prevailed for the next five months as rates varied only 5 to 7 basis points from the average of this period. During the last three months of the year because of fears the domestic economy was overheating, interest rates rose 43 basis points from the second half low, finishing the year at 5.24%.

Chart C indicates that portfolio performance exceeded the performance target during the entire fiscal year. Since portfolio performance is to a large degree determined by the movement of market interest rates, the decline in rates during the first quarter of the year was manifested by rapidly improving performance during this period, culminating in October's peak performance for the year of 126.93% of target. This

occurred at a time when portfolio yield was still reflective of the higher yields associated with securities purchased during earlier periods. The low point of performance occurred at year-end, when performance was 101.53% of target. This performance decline is typical during periods of rapidly rising interest rates until the relatively lower yielding holdings purchased earlier have matured and are replaced by higher yielding securities. For the year, the average of the monthly portfolio rates exceeds the target at 109.94% of target. This compares to a level of 103.79% recorded last year.

V. THE INVESTMENT ADVISORY COMMITTEE

The Investment Advisory Committee has met with Finance staff responsible for investment every quarter for more than eleven years. The purpose of the meetings is review of investment strategy, approval of new investment sources, discussion of economic developments, monitoring of investment activity and consideration of proposed changes to investment practices and to the Statement of Investment Policy.

The result has been safe investment, improved investment standards, improved investment quality and maintenance of an invaluable sounding board for staff concerns about the economy, the direction of interest rates, downrating of well-rated issuers of securities and a variety of other subjects related to the treasury operation.

The Advisory Committee consists of the Assistant City Manager (the Chairman), the City Attorney (represented by the Assistant City Attorney), Professor Richard Zock of California State University, Hayward, and two department heads appointed by the City Manager. Appointees currently are the City Clerk and the Public Works Director. The City Council has authorized appointment of an additional Committee member, one who would be a representative of the City's financial community. Recruitment efforts for this additional appointment are continuing.

Professor Zock's contribution to the Committee again deserves particular thanks. His economic and financial expertise have been invaluable to maintenance of prudent, effective investment, and his insights and humor make meetings a pleasure to attend.

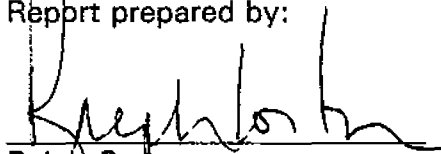
VI. INVESTMENT STRATEGY FOR 1999-2000

The investment strategy for 1999-2000 anticipates that the Federal Reserve Board's focus will likely be on the level of growth in the domestic economy. Employment continues at near-record levels and stock market valuations are near record highs, consequently, consumer spending remains strong, promoting a vigorous economy. Price inflation remains relatively benign, but signs of strain are beginning to appear. Commodity prices have firmed with strong domestic demand and competition for goods from reviving foreign economies. Economic data are beginning to provide evidence of developing growing wage pressures.

At the end of June, the Federal Reserve (the Fed) raised interest rates 25 basis points in response to what it perceived as growing inflationary pressure in the economy. Rates were increased another 25 basis points on August 24th indicating that the Fed remains concerned about inflation, and remains willing to act preemptively to counteract it.

The investment strategy assumes that rates may stabilize at the levels prevailing following this second, most recent rate increase by the Fed. There remains the possibility, however of further increases if the Fed does not believe that 50 basis points of rate increase is sufficient to combat inflationary pressures. As a consequence, we will continue to liquidate investments in L.A.I.F. over time and purchase alternative permitted investments. We will replace maturing securities with new securities, rather than increasing the amount held in L.A.I.F. The maturity of new purchases will consider the shape of the yield curve, that is, the point at which extension of maturity offers the greatest increment of yield; limited however by the maturity and diversification requirements contained in the Statement of Investment Policy. Additionally, alternative types of investments will be considered in order to take advantage of increments of yield they may offer. All such purchases will be made in consideration of the diversification and cash flow requirements of the portfolio, and quality will continue to be emphasized. L.A.I.F. will continue to be used to maintain adequate liquidity.

Report prepared by:


Ralph Costa
Purchasing and Services Manager

Approved by:

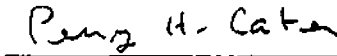

Perry H. Carter
Director of Finance

CHART A

WEIGHTED PERCENT OF PORTFOLIO DIVERSIFICATION BY INVESTMENT TYPE

	CD'S	Asset Backed	Medium Term Notes	US Gov't	Bank** Accounts	LAIF	Repos	Bank Accept
Jul-98	2.66%	12.60%	20.60%	33.79%	0.95%	29.39%	0.00%	0.0
Aug	2.73%	12.89%	18.35%	34.57%	0.78%	30.68%	0.00%	0.0
Sept	2.71%	12.83%	18.25%	31.15%	0.64%	34.42%	0.00%	0.0
Oct	0.00%	13.18%	21.54%	31.99%	0.28%	33.02%	0.00%	0.0
Nov	0.00%	13.80%	22.56%	24.77%	4.13%	34.73%	0.00%	0.0
Dec	0.00%	12.18%	17.99%	19.29%	0.62%	49.91%	0.00%	0.0
Jan-99	0.00%	8.73%	18.88%	16.18%	1.56%	54.64%	0.00%	0.0
Feb	0.00%	2.68%	21.62%	18.91%	1.38%	55.41%	0.00%	0.0
Mar	0.00%	4.87%	15.91%	14.68%	1.64%	62.89%	0.00%	0.0
Apr	2.37%	4.72%	22.51%	17.78%	0.15%	52.46%	0.00%	0.0
May	5.98%	4.76%	22.71%	20.33%	0.15%	46.08%	0.00%	0.0
Jun	8.22%	4.67%	23.46%	22.30%	0.38%	40.97%	0.00%	0.0
Policy Limits	30.00%	*	30.00%	none	*	*	25.00%	40.0

* Deposits shall not exceed total paid up capital and surplus of any depository bank of the total net worth of any savings and loan institution.

** Includes the zero-interest certificate of deposit that pays for bank service

CHART B

WEIGHTED PERCENT OF PORTFOLIO MATURATION BY MONTH

	Average Maturity Days	Months to Maturity			
		0-1	1-6	6-9	9-12
Jul-98	273	33.00%	13.63%	14.80%	2.65%
Aug	258	33.84%	21.74%	7.67%	1.36%
Sept	235	37.77%	22.98%	2.70%	1.36%
Oct	241	36.07%	20.83%	2.77%	1.39%
Nov	217	41.04%	19.63%	1.46%	0.00%
Dec	166	55.67%	12.20%	1.29%	0.00%
Jan-99	162	56.21%	12.79%	0.00%	0.00%
Feb	204	60.84%	2.69%	0.00%	0.00%
Mar	192	64.53%	2.44%	0.00%	0.00%
Apr *	265	54.97%	0.00%	0.00%	4.75%
May	281	46.23%	0.00%	2.39%	15.55%
Jun	280	41.35%	0.00%	2.35%	21.13%

A - 12

INVESTMENT POLICY LIMITS

400

- * The Investment Policy provided that no more than 40% of the portfolio may be invested beyond twelve months. During April 40.28% was invested beyond twelve months, exceeding the policy limitation by 0.28%. This policy exception cured itself during May as securities with a par value of \$4 million moved to the 270-359 day category from the 360-719 day category.
- The final security purchased during April was priced on the 27th and at the time of purchase there was no policy violation. With processing of payroll on April 30th, the payout of cash reduced the portfolio balance sufficient to create the violation at month end. The dollar equivalent of the 0.28 % invested beyond one year is \$233,793.

CHART C

YIELD PERFORMANCE RATE BY MONTH

	Investment Policy Target Yield	Actual Yield	Performance Rate *
Jul-98	5.51%	5.78%	104.90%
August	5.45%	5.78%	106.06%
September	5.15%	5.77%	112.04%
October	4.53%	5.75%	126.93%
November	4.93%	5.51%	111.76%
December	4.92%	5.59%	113.62%
Jan-99	4.85%	5.45%	112.37%
February	4.94%	5.37%	108.70%
March	4.97%	5.24%	105.43%
April	4.81%	5.32%	110.60%
May	5.03%	5.30%	105.37%
June	5.24%	5.32%	101.53%
AVERAGE	5.03%	5.52%	109.94%

* The performance percentage reflects how much better or worse the actual portfolio yield was in relation to the portfolio target yield. Our average performance percentage for 1997-98 was 103.79%. This year it is 109.94%, beginning the year at 104.9% in July, peaking at 126.93% in October when the target rate was at its low for the year, and falling to 101.53% by year end as the portfolio effective yield began to decline in tandem with the decline in market interest rates which lasted until April. With the increase in target interest rates beginning in May, portfolio performance was in decline at year end.

CHART D

PAR VALUE, COST, YIELD, AND MATURITY OF FUNDS INVESTED BY MONTH AND QUARTER

A - 14

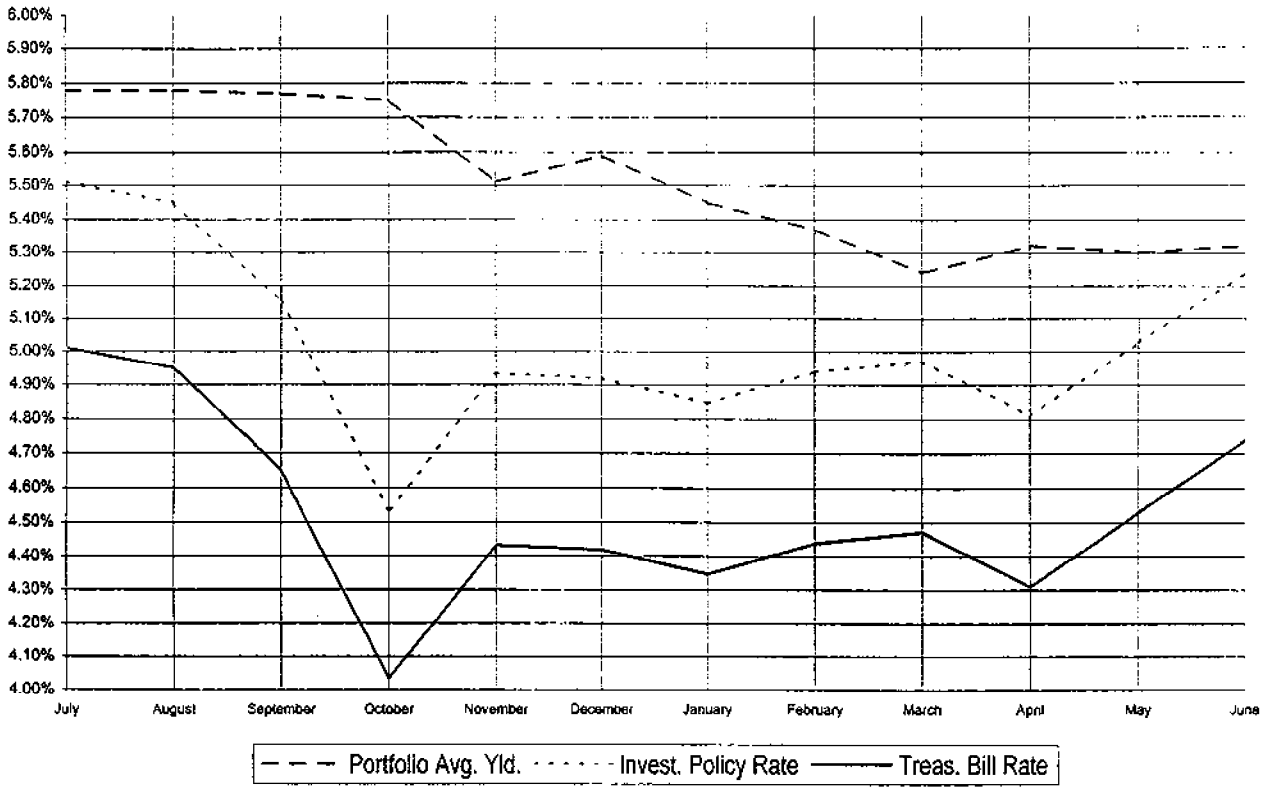
	<u>July</u>	<u>August</u>	<u>September</u>	<u>First Quarter Average</u>	<u>October</u>	<u>November</u>	<u>December</u>
Par Value (000's)	75,159	73,466	73,849	74,158	71,897	68,630	77,733
Total Cost (000's)	75,034	73,343	73,727	74,035	71,776	68,520	77,633
Average Yield	5.78%	5.78%	5.77%	5.78%	5.75%	5.51%	5.59%
Average Maturity	273	258	235	255	241	217	166
	<u>January</u>	<u>February</u>	<u>March</u>	<u>Third Quarter Average</u>	<u>April</u>	<u>May</u>	<u>June</u>
Par Value (000's)	74,107	73,972	81,668	76,582	84,325	83,622	85,207
Total Cost (000's)	74,026	73,906	81,616	76,516	84,250	83,552	85,133
Average Yield	5.45%	5.37%	5.24%	5.35%	5.32%	5.30%	5.32%
Average Maturity	162	204	192	186	265	281	280

CHART E
RATINGS OF 1998-99 PURCHASES

<u>Security Purchased</u>	<u>Purchase</u>	<u>Par</u>	<u>Rating</u>	<u>Maturity</u>
Fed. National Mort'g. Assoc.	07/30/98	2,000,000	AAA	07/21/00
Fed. National Mort'g. Assoc.	02/09/99	2,000,000	AAA	02/09/01
Fed. National Mort'g. Assoc.	02/09/99	2,000,000	AAA	02/09/01
Carco Auto Loan MT ABS	03/10/99	2,000,000	AAA	03/15/01
Federal Home Loan Bank	03/15/99	2,000,000	AAA	03/15/01
Federal Home Loan Mort'g Corp.	04/01/99	3,000,000	AAA	03/01/01
Federal Home Loan Mort'g Corp.	04/12/99	2,000,000	AAA	03/01/01
Federal Home Loan Bank	05/19/99	2,000,000	AAA	05/19/00
Federal Home Loan Bank	06/14/99	2,000,000	AAA	06/14/00
# purchased/owned %		Total \$	% \$	
9 42.86%		\$19,000,000	47.50%	
Bayerische Landesbank YCD	04/20/99	2,000,000	A1+/P1	03/21/00
Norddeutsche Bank NY YCD	05/14/99	1,000,000	A1+/P1	05/15/00
Deutsche Bank NY YCD	05/17/99	2,000,000	A1+/P1	04/25/00
# purchased/owned %		Total \$	% \$	
3 14.29%		\$5,000,000	12.50%	
Bank One Med. Term Note	04/06/99	2,000,000	AA2/AA-	02/05/01
First Chicago National Bk.	05/11/99	2,000,000	AA2/AA-	04/20/00
Key Bank Bk Note	06/16/99	2,000,000	AA3/A	06/16/00
# purchased/owned %		Total \$	% \$	
3 14.29%		\$6,000,000	15.00%	
International Lease Finance	01/11/99	1,000,000	A1/A+	01/15/02
Chrysler Financial Co.	04/14/99	2,000,000	A1/A+	01/22/01
International Lease Finance	04/30/99	2,000,000	A1/A+	09/18/01
Caterpillar Financial Services	02/12/99	2,000,000	A2/A+	09/12/01
General Motors Acceptance	10/20/98	2,000,000	A2/A	10/20/00
Xerox Credit Corp.	06/21/99	1,000,000	A2/A	03/31/00
# purchased/owned %		Total \$	% \$	
6 28.57%		\$10,000,000	25.00%	
Grand Total				
21		\$40,000,000		

CHART F

INVESTMENT PERFORMANCE



GLOSSARY

INVESTMENT TERMS

BASIS POINT: One one-hundredth of 1% or .01%. It is the smallest measure used in quoting yields (earnings) on bonds and notes.

BROKER: A middleman who brings buyers and sellers together and handles their orders, generally charging a commission for his services. The broker does not own or take a position in the security.

COLLATERAL: Securities pledged by a financial or investment institution to secure deposits or transactions of an investor.

CURRENT YIELD: The annual interest earning on a security divided by the current market value.

DISCOUNT: The difference between the current market value of a security and its face value.

EFFECTIVE RATE: The annual interest earning on a security divided by its original purchase price.

L.A.I.F.: The Local Agency Investment Fund. This is the fund in which the State of California pools its investments and the investments of California public agencies which participate in L.A.I.F. An agency participates by depositing funds in the State pool for investment by the State.

MARKET VALUE: The price at which a security is trading and at which it could presumably be purchased and sold.

PAR: (1) Price at 100% of face value. (2) The principal amount at which the issuer of the security contracts to redeem it at maturity.

PORTFOLIO: Collection of securities held by an investor.

PREMIUM: (1) The amount by which the price at which an issue is trading exceeds the issue's par value. (2) The amount which must be paid in excess of par to call or refund an issue before maturity.

RATING AGENCY: A firm which evaluates security issuers' investment and credit risk. The agencies include Fitch Investor's Service, Moody's Investment Service and Standard & Poor's Corporation.

RETURN: Profit on a security or capital investment usually expressed as an annual percentage rate.

YIELD: Return on an investor's capital investment. Two specific types of yield are defined under "Current Yield" and "Yield to Maturity."

YIELD TO MATURITY: The rate of return derived from a security if held to maturity when both interest payments and the investor's principal premium or discount on the security are taken into account.

TYPES OF INVESTMENT

BANKER'S ACCEPTANCE (BA): A draft or a bill accepted by a bank or trust company to finance trade. It is issued on a discounted basis and offers three levels of investor protection.

CERTIFICATE OF DEPOSIT(CD): Receipt for funds deposited in a bank for a specific period for a specified rate of interest. The CD may be secured or made safe with federal insurance or by collateralization.

TYPES OF CD: (1) Non-negotiable CD: A CD that cannot be sold or cashed without penalty before maturity. Collateralized CDs are non-negotiable. (2) Negotiable CD: A large denomination CD issued by large banks and traded on the open market. They are not collateralized but are rated in terms of the financial security of their issuer.

COMMERCIAL PAPER: Short-term corporate IOUs, generally due in less than a year and sold at a discount from face value.

GOVERNMENTS: As used in the United States, all types of security issues of the federal government and federal agencies.

MEDIUM TERM NOTES (MTN): Corporate promissory notes of 9-month to 15-year duration sold through dealers on a continuously-offered basis. Like certificates of deposit, MTN's can be either collateralized or unsecured. Issuers include banks and savings and loans, insurance companies and corporations.

REPURCHASE AGREEMENT (RP OR REPO): The purchase of portfolio securities by an investor with a simultaneous agreement to resell the securities back to the seller on a specific future date, at the original purchase price, plus a negotiated interest payment. This transaction may be secured or made safe with collateralization.

Attachment B

STATEMENT OF INVESTMENT POLICY

November 19, 1996

with amendments of October 28, 1997

EXHIBIT "B" TO RESOLUTION NO. 99-_____

CITY OF HAYWARD

STATEMENT OF INVESTMENT POLICY

I. Introduction

The purpose of this document is to identify various policies and procedures that enhance opportunities for a prudent and systematic investment process. The initial step toward a prudent investment policy is to organize and formalize investment-related activities. Related activities which comprise good cash management include accurate cash projection, the expeditious collection of revenue, the control of disbursements, cost-effective banking relations, and short-term borrowing program which coordinates working capital requirements and investment opportunity. In concert with these requirements are the many facets of an appropriate and secure short-term investment program.

II. Scope

It is intended that this policy cover all short-term operating funds and investment activities under the direct authority of the City. These funds are described in the City's annual financial report and include:

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Enterprise Funds
- Internal Service Funds
- Fiduciary Funds
- Redevelopment Agency Funds
- Housing Finance Agency Funds
- Industrial Development Authority Funds

This investment policy applies to all transactions involving the financial assets

and related activity of the foregoing funds.

Specifically excluded from this policy are the assets and investments comprising the Deferred Compensation Fund. Investment of these monies are directed by each employee in accordance with the rules of the Deferred Compensation Plan of the City.

Also excluded are employer and employee deposits in the PERS Fund; and employer and employee deposits in the PARS Fund.

Monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements may be invested in accordance with the ordinance, resolution, indenture or agreement approved by the City Council which govern the issuance of those bonds, or lease installment sale, or other agreement, rather than this Statement of Investment Policy.

III. Objectives

- A. Safety of a principal is the foremost objective of the City, followed by liquidity and yield. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they be from securities defaults or erosion of market value.
- B. Investment decisions should not incur unreasonable investment risks in order to obtain current investment income.
- C. The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. This need for investment liquidity may be tempered to the extent that the City is able to issue short-term notes to meet its operating requirements.
- D. The investment portfolio shall be managed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow requirements, and state and local law, ordinances or resolutions that restrict the placement of short-term funds.
- E. The investment portfolio shall be managed with the objective of regularly exceeding by 50 basis points, the average of three-month and six-month U.S. Treasury Bill rates for the equivalent period. These indices are considered benchmarks for riskless investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The

investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

- F. The City's investment portfolio will be diversified to avoid incurring unreasonable and avoidable risks associated with concentrating investments in specific security types or in individual financial institutions.
- G. While the City will not make investments for the purpose of trading or speculation as the dominant criterion, the Director of Finance shall seek to enhance total portfolio return by means of active portfolio management. The prohibition of speculative investments precludes pursuit of gain or profit through unusual risk and precludes investments primarily directed at gains or profits from conjectural fluctuations in market prices. However, as long as the original investments can be justified by their ordinary earning power, trading in response to changes in market value or market direction is a requirement of active portfolio management.
- H. The City adheres to the guidance provided by the prudent investor standard which obligates a fiduciary to ensure that investments shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.
- I. All participants in the investment process shall act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. The overall program shall be designed and managed with a degree of professionalism that is worthy of the public trust. Nevertheless, in a diversified portfolio, it must be recognized that occasional measured losses are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

IV. Delegation of Authority

In accordance with Section 53607 of the California Government Code, the responsibility for conducting the City's investment program is delegated to the Director of Finance, who has established written procedures for the operation of the investment program, consistent with this investment policy, which also govern delegation of authority for all investment activities.

V. Investment Advisory Committee

The City Manager will appoint an investment advisory committee for the purpose of overseeing the implementation of the City's investment program and assuring it is consistent with the investment policy as approved by the Council. The advisory committee shall consist of the Assistant City Manager, the City Attorney, a representative of California State University at Hayward, a member of the financial community, and two department heads chosen by the City Manager.

The investment advisory committee shall meet at least quarterly to determine general strategies and to monitor results. The committee shall include in its deliberations such topics as: economic outlook, portfolio diversification and maturity structure, potential risks to the City's funds, approval of authorized financial institutions, and the target rate of return on the investment portfolio. Written investment procedures must be approved by the investment advisory committee.

VI. Reporting: Interim and Annual

Monthly

Within 30 days of the end of each month the Director of Finance shall submit a monthly investment report to the City Manager and the City Council and shall provide copies to the Chairman and Members of the Investment Advisory Committee. Graphs, charts or schedules of the monthly report shall itemize the month's investment purchases, sales and maturities and indicate their effect on portfolio value, both individually and by investment category; itemize all investments and deposits in the portfolio by investment or deposit category, providing essential identifying characteristics for each investment or deposit; indicate the percentage of the portfolio represented by each investment and by each investment category; show all par values, market values and costs at time of purchase, together with each item's coupon or discount rate and current earning rate; show the average earning rate for the portfolio together with daily earnings and monthly earnings by item, by category and in total; indicate distribution of the portfolio by maturity category and from 0-29 days to two to four years; and provide other relevant detail to accomplish exemplary disclosure of investment activity and portfolio status.

The text of the monthly report shall highlight key aspects of information contained in investment report schedules; inform readers of economic conditions affecting the portfolio, recent investment performance and future investment strategy; disclose any perceived threats to portfolio quality, security or liquidity; compare the average portfolio investment yield with the portfolio target yield defined in Section III E above; incorporate by reference the most recent report received by the City from the State of California Local Agency Investment Fund

(LAIF) detailing the investment types, issuers, maturity dates, par values and investment amounts comprising the pooled monies held by the state; and provide information as to the source of the market valuation data provided in the report. As use of the report discloses ways in which communication can be improved, the report will be enhanced with a view to achieving optimum disclosure of investment activity and portfolio status.

Annual

Within 60 days of the end of the fiscal year the Director of Finance shall present a comprehensive annual report on the investment program and investment activity. This report shall be presented to the Investment Advisory Committee. The annual report shall include twelve-month and separate quarterly comparisons of return, shall suggest policies and improvements that might enhance the investment program, and include an investment plan for the ensuing fiscal year.

In conjunction with its review of the annual investment report, the Investment Advisory committee shall review and reaffirm the Statement of Investment Policy of the City, whether or not specific policy modifications are suggested as part of the annual report.

Following the annual review of the Statement of Investment Policy by the Investment Advisory Committee, the Investment Policy shall be submitted to the City Council together with any changes recommended by the Advisory Committee. The City Council shall consider any such recommended changes and annually reaffirm the Statement of Investment Policy at a public meeting of the City Council.

VII. Investment Instruments

Investment instrument authorized for purchase by the City include:

- A. U.S. Treasury, agency and instrumentality obligations maturing within four years;
- B. certificates of deposit;
- C. prime bankers' acceptances with maturities less than 270 days, which are eligible for purchase by the Federal Reserve System, and are issued by the top 50 banks in the world, or any qualified depository in the State of California with a 4.5 percent equity to asset ratio. Purchases from any one bank may not exceed 30 percent of the City's investment portfolio;
- D. prime commercial paper;

- E. medium term corporate notes with
 - (a) a maximum maturity of two years issued by corporations doing business in the United States which are rated "A" or its equivalent or better by one or more of the four following national rating services: Moody's, Standard and Poor's, Fitch's or Keefe's;
 - (b) a maximum maturity of three years, A+ or its equivalent or better; or
 - (c) a maximum maturity of four years, AA or its equivalent or better.
- F. State of California Local Agency Investment Fund;
- G. County agency investment fund;
- H. repurchase agreements; and
- I. reverse repurchase agreements for cash flow purposes when authorized by the City Council and
 - (a) with securities owned and previously paid for for a minimum of 30 days prior to the settlement of the reverse repurchase agreement
 - (b) shall not exceed 20% of the portfolio
- J. mutual funds meeting the requirements of Section No. 53601(k) of the State Government Code, provided that use of mutual funds shall be limited to bond proceeds for which the City Treasurer finds a mutual fund's accounting methods particularly suited to the accounting requirements of the bond issue and helpful with arbitrage calculations.
- K. Asset-backed corporate notes of the following characteristics:
 - (a) Minimum rating agency rating of the issuer: A, its equivalent, or better
 - (b) Minimum rating agency rating of the asset-backed securities themselves: AA, its equivalent, or better.
 - (c) Maximum percentage of the portfolio permissible for asset-backed securities: 20 percent. However, because medium term notes and asset-backed securities are both corporate securities, and because the 30 percent ceiling on medium term notes and 20 percent

ceiling on asset-backed securities could result in an undue concentration of investments in corporate securities, the combined share of the portfolio occupied by the two classes of corporate securities shall not exceed 40 percent.

- (d) Mortgage-backed corporate notes shall not be invested in.
 - (e) Maturity limits: "Bullet" maturity, four years; "Stated Final" maturity, five years.
- L. The City shall not invest any funds in any security that could result in zero interest accrual if held to maturity. This limitation shall not apply to investments in shares of beneficial interest issued by diversified management companies as provided for in Section VII.J., above; or to such prohibited investments held at the time this section is adopted.
 - M. The City shall not invest any funds in inverse floaters, range notes, or interest only strips that are derived from a pool of mortgages.
 - N. The limitations set forth in Section VII. L. and M., above shall not apply to investments in shares of beneficial interest issued by diversified management companies as provided for in Section VII. J., above; or to such prohibited investments held in the portfolio at the time this section is adopted.

VIII. Investment Terms and Conditions

- A. The following terms and conditions shall apply to the use of repurchase agreements:
 - 1. Securities purchased under the repurchase agreement shall be limited to the securities and qualifications listed above.
 - 2. Securities shall be marked-to-market daily, and shall be maintained at a value equal to or greater than the cash investment.
 - 3. At the time of purchase the market value of the securities shall be in excess of the cash investment.
 - 4. All securities purchased under a repurchase agreement shall be held by a third-party custodian or safekeeping agent. Transfer of underlying securities to a counterparty bank's customer book entry account may be used for book entry delivery, and a counterparty bank's trust department or safekeeping department may also be used for physical delivery of the underlying security.

5. The seller of repurchase securities shall not be entitled to substitute securities, except as authorized by the City. New or substitute securities should be reasonably identical to the original securities in terms of maturity, yield, quality, and liquidity.
 6. "Retail" repurchase agreements shall not be authorized for purchase.
 7. As soon as possible a master repurchase agreement shall be executed between the City and all trading partners.
- B. The following terms and conditions shall apply to the use of commercial paper:
1. Maturities shall be limited to 180 days or less.
 2. Purchases must be of the highest letter and numerical rating as provided for by Moody's or Standard and Poor's rating services.
 3. Purchases must be limited to corporations organized and operating within the United States, having total assets in excess of five hundred million dollars, and having an "A," its equivalent or higher rating for the issuer's debentures, other than commercial paper (as provided for by Moody's or Standard and Poor's rating service).
 4. Purchases may not represent more than 10% of the outstanding paper of an issuing corporation.
- C. The following terms and conditions shall apply to the use of negotiable certificates of deposit:
1. Certificates with maturities greater than six months through one year shall have an A-2/P-2 rating or its equivalent or better as provided for by one of the four following national rating services: Moody's, Standard and Poor's, Fitch's or Keefe's.
 2. Certificates with maturities greater than one year shall have the following, equivalent or higher ratings: one through two years, A; two through three years, A + ; three through four years, AA.
- IX. In the event that a financial institution or depository receives a Standard and Poor's, Moody's, Fitch or Keefe rating equal to or lower than Standard and Poor's rating of BBB, the Finance Director promptly shall make and implement an

informed decision on whether to sell, withdraw from deposit or retain any security or deposit in the City portfolio issued or held by such affected financial institution or depository. The Finance Director may consult the Investment Advisory Committee on the action to be taken and shall advise its Chairman and Member of the final disposition of the matter either by memorandum or at the next Investment Advisory Committee meeting. If the meeting is scheduled more than a month after action is taken, the communication of disposition will be by memorandum.

X. Prudence

The standard of prudence to be used by investment officers shall be the prudent investor standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that deviations from expectation are reported in a timely fashion, and appropriate action is taken to control adverse developments.

XI. Internal Controls

The Director of Finance shall establish a system of internal controls, which shall be documented in writing. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City. Controls deemed most important include: control of collusion, separation of duties, separating transaction authority from accounting and recordkeeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, written confirmation of telephone transactions, minimizing the number of authorized investment officials, documentation of transactions and strategies, and ethical standards.

XII. Banks and Securities Dealers: Selection

In selecting financial institutions for the deposit or investment of City funds, the Director of Finance shall consider the creditworthiness of institutions. The Director of Finance shall continue to monitor financial institutions' credit characteristics and financial history throughout the period in which City funds are deposited or invested.

Effective October 14, 1987, the City shall be prohibited from investing funds with any person which is knowingly or intentionally engaged in the development or production of nuclear weapons. Person is defined as any person, private

corporation, institution or other entity, which is within the jurisdiction of the City of Hayward.

The Investment Advisory Committee shall approve all financial institutions from which securities are purchased or sold.

Only primary government securities dealers that report to the New York Federal Reserve shall be used for the purchase of repurchase agreements. (It is acknowledged that inclusion on the primary dealer listing of the Federal Reserve Bank of New York is not a guarantee of creditworthiness.)

XIII. Maturity

The City shall not invest in instruments whose maturities exceed four years at the time of purchase. Instruments with maturities greater than two years shall be limited to (1) U.S. Treasury and agency obligations; (2) medium term notes rated "A" or its equivalent or better by at least one of the four national rating services identified above; (3) certificates of deposit rated "A", its equivalent or better by at least one of the four national rating services identified above; and (4) asset-backed notes as regards the "bullet" maturity, provided the "stated final" maturity is not more than five years. The average maturity of the City's short-term portfolio shall not exceed one year.

It is the intent that investments shall be managed in such a way that any market price losses resulting from interest-rate volatility would be offset by coupon income and current income received from the balance of the portfolio during a twelve-month period.

XIV. Diversification

It is City policy to diversify the investment portfolio in order to reduce the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. The following strategies and constraints shall apply:

- A. Portfolio maturities shall be staggered in a way that avoids undue concentration of assets in a specific maturity sector. Maturities shall be selected which provide for stability of income and reasonable liquidity.
- B. Concern for liquidity shall be insured through practices that include covering the next vendor disbursement date and payroll date through maturing investments of U.S. Treasury bills.
- C. Risks of market price volatility shall be controlled through maturity diversification such that aggregate price losses on instruments with

maturities exceeding one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

D. Specific diversification limitation shall be imposed on the portfolio as follows:

1. No more than 40% of the portfolio may be invested beyond twelve months, and the average maturity of the portfolio shall not exceed 400 calendar days.
2. Except for deposits in the Local Agency Investment Fund, instruments of the U.S. government or federal agencies fully backed by the U.S. government, and fully collateralized certificates of deposit or fully collateralized medium term notes, no more than 20% of the overall portfolio may be invested in the securities of a single financial institution.
3. The maximum proportion of the total portfolio that shall be placed at any one time in each of the categories of investment are as follows:
 - (a) Thirty (30) percent in negotiable certificates of deposit,
 - (b) Forty (40) percent in banker's acceptances,
 - (c) Thirty (30) percent in medium term notes,
 - (d) Twenty-five (25) percent in any other obligation (with the exception of commercial paper) that does not bear the full faith and credit of the United States government or which is not fully collateralized or insured,
 - (e) Twenty (20) percent in asset-backed securities provided, however, that medium term notes and asset-backed securities in combination do not exceed forty (40) percent of the portfolio.
4. No more than 15% of the portfolio may be invested through the County Treasurer in any agency investment fund which the County may establish.
5. No more than 15% of the portfolio may be invested in prime commercial paper. However, if the dollar-weighted average maturity of the entire portfolio does not exceed 31 days, an additional 15% may be invested in prime commercial paper.

6. In accordance with California statutes, City deposits including collateralized certificates of deposit shall not exceed the total paid-up capital (to include capital notes and debentures) and surplus of any depository bank, or the total of the net worth of any savings and loan association.

XV. Risk Tolerance

The City recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Portfolio diversification is employed as a way to control risk. Investment managers are expected to display prudence in the selection of securities, as a way to minimize default risk. No individual investment transaction shall be undertaken which jeopardizes the total capital position of the overall portfolio. The Director of Finance shall periodically establish guidelines and strategies to control risks of default, market price changes and illiquidity. All investment reports shall specifically address whether current investment results have been affected by any of the foregoing risks, and shall explain what actions investment officials have taken to control or correct for such risks.

In addition to these general policy considerations, the following specific policies will be strictly observed:

- A. All investment funds will be placed directly with qualified financial institutions. The City will not deposit or invest funds through third parties or money brokers.
- B. All transactions will be executed on a delivery versus payment basis.
- C. The City will not enter into reverse repurchase agreements other than for cash flow requirements; nor shall it trade in options on future contracts unless, upon recommendation by the Investment Advisory Committee, such transactions are specifically authorized by the City Council.
- D. A competitive bid process, utilizing a minimum of three financial institutions deemed eligible by the Investment Advisory Committee, will be used to place all investment purchases. Based on a quarterly evaluation, securities dealers, banks and other financial institutions will be dropped or continued on the eligibility list. The following criteria will be used in the quarterly evaluation:
 1. number of transactions competitively won

2. prompt and accurate confirmation of transactions
 3. efficient securities delivery
 4. accurate market information account servicing
- E. The Finance Director shall designate an official to manage investments and designate a second official to perform investment management during absences of the primary designee. The Finance Director shall insure that competent investment management is maintained and shall insure that, if both designated investment officials are replaced or are simultaneously absent, any temporary replacement(s) shall be closely supervised, indoctrinated in the requirements of this Statement of Investment Policy, and given written investment procedures regulating the authority to invest in maturities beyond six months by means of appropriate controls and restraining requirements.
- F. In order to assist in identifying "qualified financial institutions," the Finance Director shall forward copies of the City's Investment Policy to those financial institutions with which the City is interested in doing business and require written acknowledgement of the Policy.

XVI. Safekeeping and Custody

To protect against potential fraud and embezzlement, the assets of the City shall be held in the City's vault or secured through third-party custody and safekeeping procedures. The investment official shall be bonded to protect the public against possible embezzlement and malfeasance. Safekeeping

procedures shall be reviewed annually by an independent auditor. The auditor may conduct surprise audits of safekeeping and custodial procedures.

XVII. Investment Policy Adoption

The City's investment policy shall be formally reviewed and approved by the Investment Advisory Committee, not more than 120 days after the beginning of each fiscal year; and, thereafter shall be reviewed and approved by the City Council at a public meeting.

DRAFT

jm 10-12-99

HAYWARD CITY COUNCIL

RESOLUTION NO. _____

Introduced by Council Member _____

**RESOLUTION ACCEPTING THE ANNUAL REPORT ON
INVESTMENT PROGRAM AND ACTIVITY FOR THE CITY
OF HAYWARD, AFFIRMING THE STATEMENT OF
INVESTMENT POLICY AND RENEWING THE
DELEGATION OF AUTHORITY TO MAKE INVESTMENTS
TO THE DIRECTOR OF FINANCE**

WHEREAS, by Resolution No. 85-252 C.S. dated August 6, 1985, the City Council adopted a Statement of Investment Policy for the City of Hayward; and

WHEREAS, the Statement of Investment Policy requires the Director of Finance to submit an annual report and make recommendations for amendments to the investment program; and

WHEREAS, the Director of Finance has submitted his annual report to the City Council and recommendations for amendments of the investment program to the City Council.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Hayward that that certain report entitled "Annual Report on Investment Program and Activity for the Fiscal Year Ending June 30, 1999," attached hereto as Exhibit "A" and incorporated herein, is hereby accepted as the annual report required by the investment policy of the City of Hayward.

BE IT FURTHER RESOLVED that the Statement of Investment Policy is hereby affirmed, and that the authority of the Director of Finance, or his or her designee, to make investments pursuant to the Policy is hereby renewed.

IN COUNCIL, HAYWARD, CALIFORNIA _____, 1999

ADOPTED BY THE FOLLOWING VOTE:

AYES:

NOES:

ABSTAIN:

ABSENT:

ATTEST: _____
City Clerk of the City of Hayward

APPROVED AS TO FORM:

City Attorney of the City of Hayward